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October 30, 2006

Congressman Bill Thomas
U.S. House of Representatives
2208 Rayburn House Office Building
Washington, DC 20515

RE: Comments on Sec. 7 of the Tax Technical Corrections Act of 2006 (H.R. 6264/S. 4026)

Dear Congressman Thomas:

Enclosed are comments prepared by Crowe Chizek and Company LLC regarding Section 7 of the Tax Technical Corrections Act of 2006 (H.R. 6264/S. 4026). These comments were prepared by Stephen C. Honhart and Stephanie M. Lane, members of the International Tax Services Group at Crowe Chizek and Company LLC.

We appreciate your consideration of these comments. If you have any questions, please contact me at (616) 752-4238, or shonhart@crowechizek.com.

Sincerely,

A handwritten signature in cursive script, reading "Stephen C. Honhart".

Stephen C. Honhart

Partner, International Tax Services Group
Crowe Chizek and Company LLC

cc: Senator Max Baucus, U.S. Senate
Senator Charles Grassley, U.S. Senate

Comments on

Sec. 7 of the Tax Technical Corrections Act of 2006 (H.R. 6264/S. 4026)

Proposed

Sec. 7. AMENDMENT RELATED TO THE JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003.

(a) AMENDMENT RELATED TO SECTION 302 OF THE ACT.--Clause (ii) of section 1(h)(11)(B) is amended by striking "and" at the end of subclause (II), by striking the period at the end of subclause (III) and inserting ", and", and by adding at the end the following new subclause:

"(IV) any dividend received from a corporation which is a DISC or former DISC (as defined in section 992(a)) to the extent such dividend is paid out of the corporation's accumulated DISC income or is a deemed distribution pursuant to section 995(b)(1).".

(b) EFFECTIVE DATE.--The amendment made by this section shall apply to dividends received on or after September 29, 2006, in taxable years ending after such date.

General Comments

Congress has a history of stimulating the export of goods from the United States. In the past, Congress attempted to increase exports by providing incentives to U.S. exporters by enacting the foreign sales corporation ("FSC") and its successor, the extraterritorial income exclusion ("ETI") legislation. However, because the World Trade Organization's ("WTO") challenge of the FSC and ETI regimes resulted in the repeal of both pieces of legislation, the only remaining export incentive for U.S. exporters is the domestic international sales corporation ("DISC").

Originally adopted in 1971, the DISC regime was intended to induce an increase in export activities for U.S. companies by allowing them to receive a deferral on a portion of the income attributable to their export activity. Under the DISC regime, a portion of the income attributable to the export activity was segregated in a separate legal entity, namely the DISC, which was not subject to U.S. income tax. U.S. foreign trading partners contended that the DISC regime was an illegal export subsidy because it allowed a portion of the DISC earnings to be retained tax free without an interest charge. In response, the U.S. introduced the "Interest Charge DISC." In order to comply with General Agreements on Tariffs and Trade requirements, the U.S. added an interest charge component to the DISC in 1984.

For federal income tax purposes, the DISC is classified as a domestic corporation whose income is derived almost exclusively from U.S. export-related activities. The DISC itself is not subject to income tax; however, DISC shareholders can be taxed on the DISC's income for actual or deemed distributions. Despite shareholders' taxation on DISC distributions, they still receive limited tax deferral on income from export sales and certain other services.

Under section 1(h)(11) created by the Jobs Growth Tax Relief Reconciliation Act of 2003 ("JAGRTA"), certain dividends earned by individual taxpayers are taxed at long-term capital

gain rates. Section 1(h)(11) applies to virtually all dividends paid by domestic corporations and certain qualified foreign corporations. Further, this section provides that the reduced rate is rendered unavailable for certain excluded dividends listed under Section 1(h)(11)(B)(ii). A DISC is a domestic corporation by definition, and because DISC dividends are not listed on the excluded dividends list, they would qualify for capital gains rate treatment under the current law. If Congress enacts the proposed amendment, dividends from DISCs or former DISCs would be considered ineligible for capital gains rate treatment. DISC shareholders will no longer be able to take advantage of the favorable capital gains rate on the dividend payment from DISCs or former DISCs, which will ultimately be detrimental to the U.S. export industry. Without the incentive of favorable capital gains rates on dividends from DISCs or former DISCs, exports will go down thus having a negative impact on the U.S. economy.

Since the enactment of JAGTRA, two Tax Technical Corrections Acts have been submitted to Congress, both of which have not included an amendment to change the tax treatment of dividends from a DISC or former DISC under section 1(h)(11)(B). Congress' omission of this amendment in prior Tax Technical Corrections Acts was generally viewed by taxpayers as an indication that Congress had no intention of changing the language under section 1(h)(11)(B) to specifically exclude dividends received from a DISC or former DISC as qualified dividends subject to capital gains rate treatment. Many taxpayers opted to use the benefits originally provided under the Interest Charge DISC regime and spent considerable sums to utilize this business entity form. Their reliance on this structure has helped to build the economy and stimulate growth in the export industry. By taking no prior action, perhaps Congress was acknowledging that dividends from DISCs or former DISCs should be qualified under section 1(h)(11)(B).

If Congress pushes forward with the proposed amendment to section 1(h)(11)(B), we propose the following changes to the amendment:

Effective Date

At the very least, Congress should consider modifying the effective date to allow taxpayers to transition out of the structure. Enacting the amendment effective September 29, 2006, will affect taxpayers estimated tax payments because under the current law, DISC dividends and deemed dividends would still be qualified. By delaying the effective date, Congress will give taxpayers time to transition their business structures. We propose an effective date for years ending on or after January 1, 2008.

Taint Earnings and Profits

Congress should consider rewording the amendment so that dividends from pre-enactment earnings and profits ("E&P") are still eligible for capital gains rate treatment, while those dividends from post-enactment E&P fall under the proposed change as unqualified dividends under section 1(h)(11)(B). In essence, this will taint the E&P rather than the dividend stream and will allow taxpayers to take advantage of the benefits under the law as originally written. Currently, the amendment is written such that dividends from a DISC or former DISC will no longer be qualified under section 1(h)(11)(B). Any pre-enactment E&P of the DISC or former DISC, if distributed after the effective date, will be considered unqualified dividends taxed as ordinary income even though the E&P was created before the effective date. Taxpayers will not be able to take advantage of the lower tax rates to which they were initially entitled on the pre-

enactment E&P, thereby making the proposed legislation, in effect, retroactive rather than prospective. A proposed solution is to apply the amendment to the E&P created after the effective date, and not to the dividend stream.

Making these proposed changes to Section 7 of the Tax Technical Corrections Act of 2006 will allow taxpayers the time to transition their business structures as well as take advantage of the benefits under the law as originally written.